GUARDIAN
FEDERAL CREDIT UNION
Always Ready To Serve Since 1956
P.O. Box 1337 ::: Portsmouth, VA 23705 ::: 757.397.1234 ::: Toll-Free 800.659.1850 ::: Fax 757.393.9447 ::: www.guardianfcu.org

March 26, 2009

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 23414-3428

Subject: Comments on Advanced Notice of Proposed Rule making for Part 704, Corporate Credit Union Strategy

Dear Ms. Rupp:

In Letter to Credit Unions 09-CU-02 the National Credit Union Administration (NCUA) solicited comments on their Corporate Credit Union Strategy via an Advanced Notice of Proposed Rulemaking (APNR). The primary concerns addressed in the ANPR are: (1) the role of the corporates in the CU system; (2) corporate capital; (3) permissible investments; (4) credit risk management; (5) asset liability management; and, (6) corporate governance. It is our understanding that the NCUA wishes responses to be as wide-ranging as possible, so we have added a seventh category, which deals with Natural Person Credit Unions.

As a preface to our comments, the NCUA should understand that Guardian values and relies upon its member-owner relationship with Virginia Corporate FCU. We rely upon them for credit needs, both overnight, and term, a variety of payment services, investments, investment safekeeping, the sale and purchase of jumbo certificates, economic advisories and, investment advice. We doubt that as reasonably priced and professional products and services are available outside of the movement. Our preference is to form partnerships within the movement, making it easier to recognize the uniqueness of credit unions. We believe that a well-capitalized corporate credit union system that is able to meet the investment and payment needs of the movement is vital to everyone's continued success.

1) Role of Corporates in the Credit Union System
a) **Payment System:** Currently, payment services offered by corporates are coupled with other services.
Response: Payment services should be considered a core service of the corporate system. Payment services risk has been well managed there is no reason to offer separate charter types for payment service and investment services. This is a competitive service arena with a shrinking number of players due to shrinking margins. A credit union centric solution is desirable, and decoupling may not allow for sufficient income at the corporate level. NCUA should establish legal and operational firewalls between payment system services and other corporate services to ensure that the risk of either is appropriately

mitigated. Corporates do not necessarily have to have payment or investment services capabilities in house. Partnerships should be encouraged. What is necessary is the ability to recognize and prudently manage the associated risks.

b) **Liquidity and Liquidity Management:** A vital role of corporates is to fulfill the liquidity needs of their members. Thus, it is crucial that corporates properly consider their investment position relative to their cash flow needs.

Response: Meeting the liquidity needs of their Natural Person Credit Union members should be considered a core service of the corporate system. NCUA should not consider limiting a corporates ability to offer other specific types of products and services in order to preserve and defend their liquidity function by any other means other than a dynamic list of allowable investments and a requirement that certifiable expertise in managing each type of investment be demonstrated by the corporate. Thus, if a corporate lacks the certifiable management expertise for a particular allowable investment, that corporate should not offer the investment.

c) **Field of Membership Issues:** The allowance of national FOMs for corporates has resulted in significant, and unforeseen risk taking.

Response: There are more corporates than the member base can reasonably support. We urge NCUA to establish regional FOMs. The regional FOMs should not be so large as to make the corporate too remote, but, at the same time, should be large enough to reasonably mitigate geographic risk. There should be some method to mitigate geographic risk between the regional corporates. Regional corporate members should be required to maintain some form of ownership account, which would be included in the regional's capital calculation.

d) **Expanded Investment Authority:** Currently, corporates meeting certain criteria can qualify for expanded investment authority; such as authority to purchase investments with relatively lower credit ratings than otherwise permissible under the rule.

Response: With regional FOMs a different application of investment authority will need to be developed. Whatever authorities are granted, NCUA should require rigorous periodic re-qualification for any investment authority, especially for those investments with riskier credit ratings.

e) **Structure; Two-Tiered System:** Does the current two-tier corporate system meet the needs of credit unions? Specifically, NCUA seeks input on whether there is a continuing need for a wholesale corporate credit union.

Response: When viewed as an aggregator, there is value to a two-tier system with a wholesale corporate on top, particularly in a regionalized corporate environment. Expanded investment authority could be limited solely to the wholesale corporate who could act on behalf of the other corporates. As envisioned, the wholesale corporate would be more investment driven, and the regionals would be more payments focused, with them acting more as a delivery channel for the wholesale. As a result, capital requirements and risk measurement criteria (e.g., net asset value volatility), as well as the range of permissible investments for the wholesale corporate would be different from those that would apply to a regional corporate.

2) Corporate Capital: NCUA is considering revising certain definitions and standards for determining appropriate capital requirements for corporates.

Response: There are currently too many corporates for the movement to capitalize them properly. The corporate system begs for consolidation.
a) **<u>Core Capital</u>:** Currently, core capital is defined as retained earnings plus paid-in capital.
Response: NCUA should establish a new required capital ratio for regulatory purposes, to include the current elements, but exclude membership capital accounts. A second new ratio based on risk weighting of assets would include some form of membership capital. These changes or similar ones would make corporate capital requirements more similar to those used by the other financial regulators. Regionals would maintain a capital account with the wholesale corporate.
b) **<u>Membership Capital:</u>**
Response: NCUA should continue to allow membership capital and modify it so that membership capital meets the traditionally accepted definition of Tier two capital. The adjusted balance requirements, as currently defined in §704.3(b)(8), should be tied only to assets. Any attempted reduction in membership capital based on a downward automatic adjustment should result in the account being placed on notice, within the meaning of §704.3(b)(3), so that only a delayed payout after the three-year notice expires is permissible. There should be a requirement that any withdrawal of membership capital be conditioned on the corporates' ability to meet all applicable capital requirements following withdrawal.
c) **<u>Risk-Based Capital and Contributed Capital Requirements:</u>**
Response: NCUA should consider risk-based capital for corporates consistent with that currently required of other federally regulated financial institutions. A Natural Person Credit Union should be required to maintain a contributed membership capital account with its corporate as a prerequisite to obtaining its services. Contributed membership capital should be calculated as a function of share balances maintained with the corporate and an index representative of the services used. Regional or the retail corporates would maintain a similar capital account with the wholesale corporate. There must be access to transparent capital records of corporates so that both NCUA and member credit unions can better assess risk.

3) Permissible Investments: Currently, corporates have the authority to purchase and hold investments that would not be permissible for Natural Person Credit Unions. Thus, a member of a corporate is indirectly exposed to any risky investments held by the corporate.
Response: Corporates serve a different function than Natural Person Credit Unions and should not be limited to those investments allowed for natural person credit unions. It is not that certain categories~~,~~ or specific~~,~~ investments are of themselves bad or improper. (For example: collateralized debt obligations, net interest margin securities, and subprime and Alt-A asset-backed securities). What is extremely important is the ability of a corporate to prudently manage their investments, and mitigate and absorb any attendant risk. It would seem that a requirement for corporates to demonstrate on a regular basis certain levels of expertise would be preferable to the outright banning of an investment type, particularly, if that ban was unique solely to the credit union movement, and not levied against other financial institutions. Besides who would have ever dreamt that our government would wipe out an entire marketplace for these securities.

4) Credit Risk Management: With many questioning the reliability of credit ratings for investments, NCUA is considering limiting the extent to which a corporate may focus on ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs).
Response: NCUA should require a corporate to obtain more than one rating for an investment. The use of additional stress modeling tools should be required to enhance credit risk management. Part 704 should be revised to provide specific concentration limits, including sector and obligor limits. These limits should be developed by individuals with the expertise to do so and reviewed on a regular basis.

5) Asset Liability Management: NCUA is considering reinstating the requirement that corporates perform net interest income modeling and stress testing. Alternatively, NCUA may consider some form of mandatory modeling and testing of credit spread increases.
Response: NCUA should require corporates to use monitoring tools appropriate to their individual make-up to identify these types of trends. On a regular basis executive summary results of these tests should be shared with member-owner Natural Person Credit Unions.

6) Corporate Governance: Due to the sophistication and far-reaching impact of corporate activities, NCUA is considering several changes to corporates' boards.
Response: Given the predicament that the movement finds itself in, it would appear that the current structure of retail and wholesale corporate credit union boards may not be totally appropriate, given the current corporate business model or any that we can envision. NCUA should establish minimum standards for directors with regard to their level of experience. All corporate credit unions should have some number of Natural Person Credit Union directors. The other directors could be drawn from individuals who are officers of that corporate, officers of member Natural Person Credit Unions, and/or individual members from within credit unions themselves. Director terms should not be limited but elected board officer terms should be. Unpaid volunteerism is a movement ethos; no board member should be compensated.

7) Other Comments: NCUA also seeks comment on any other relevant issues pertaining to corporate credit unions that have not been addressed in this ANPR.
Response:
Prompt Corrective Action (PCA). We are concerned some credit unions will have their capital reduced to PCA levels as a result of the proposed rule change. Despite recent guidance from NCUA to its examiners, we fear that the guidance is not specific enough to prevent possible adverse actions being taken against credit unions whose net worth has been taken below PCA levels by a situation totally beyond their control. Some consideration should be given to either to lessening required capital levels under PCA or temporarily suspending corrective action measures.

Impact on fixed asset waivers. Our credit union is the recipient of a fixed asset waiver that expires 12/2010. The impact of the proposal will make it impossible for us to meet the projections made regarding reducing our fixed asset ratio below 5%. NCUA should grant waiver extensions without reams of labor-intensive documentation being required.

Risk based capital. NCUA should adopt risk-based capital for Natural Person Credit Unions. Without risk-based capital, credit unions are handicapped when compared to other financial institution types.

Alternative capital forms. NCUA should allow alternative forms of capital for Natural Person Credit Unions. With shrinking margins, funding capital solely through retained earnings makes credit unions non-competitive and puts the NCUSIF at higher risk.

Director qualification. NCUA should establish director qualifications beyond those that currently exist in the standard bylaws. At minimum, a high school diploma, equivalent, or a specified number of years of related work experience should be required.

Director education. Once elected, a director should be required to complete specified courses during his/her initial term. Additional courses would be required with each successive term. The requirement for ongoing education should be tempered by the complexity of the credit union.

Regulator responsibility. The NCUA has long told natural Person Credit Unions that unlimited deposits in corporates were considered safe and free from the need to perform rigorous due diligence analysis for amounts in excess of the insured amount. This has led many smaller credit unions to rely almost exclusively on their corporate apparently to their detriment. Specifically it now appears that the conservatorship of US Central will result in substantial impairment of natural person credit union membership capital shares in corporates. The result may be a doubling of the recapitalization expense to natural person credit unions as we recapitalize the insurance fund and our corporate. The NCUA owes the movement more transparency if we are to rely their guidance.

We thank you for the opportunity to express our views on the ANPR.

Sincerely,

Christopher E. Anuswith, CCUE
President / CEO

cc: Virginia Credit Union League